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No. 80-140

IN THE

Supreme Court of the United States

October Term, 1980

M.G.R.S., INC.,

Petitioner,

vs.

STATE BOARD OF EQUALIZATION OF THE STATE OF CALIFORNIA,

Respondent.

RESPONDENT'S OPPOSING BRIEF.

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Questions as Presented by Petitioner.

1. Can California deny that this transportation between two points in California but traversing 20 miles of high seas outside California is "interstate or foreign commerce," in the face of this Court's holding to the contrary in *Lord v. Steamship Company* and subsequent cases?

2. Can California extend its boundaries beyond both the federal and state boundaries established by this Court in *United States v. California*, so as to define this transportation as not being "interstate or foreign commerce?"

3. Can California deny that this vessel, which carries prepaid passengers from other states and foreign countries, is engaged in "interstate or foreign commerce" as defined by this Court in *The Daniel Ball* merely because these passengers constitute a minority of passengers on a minority of voyages?

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The petitioner has petitioned this Honorable Court for a Writ of Certiorari to the Supreme Court of the State of California, after its petition for hearing was denied by that court following an adverse decision in the California Court of Appeal. (*M.G.R.S., Inc. v. California State Board of Equalization*, unpublished opinion filed March 7, 1980, Supreme Court hearing denied April 30, 1980.)

This case involves a California Sales and Use Tax exemption statute. Without the exemption provided in California Revenue and Taxation Code sections 6368 and 6368.1,[1] the activities of petitioner could be constitutionally taxed under the California Sales and Use Tax Law without offending the Commerce Clause of the United States Constitution. Petitioner has not argued to the contrary at the Courts below and does not presently contend otherwise. (Petition, page 13.) Consequently, there is no federal question for this Honorable Court to decide. The petition for a Writ of Certiorari to the United States Supreme Court should be respectfully denied.[2]

In its petition, petitioner contends that the lower courts' decision in this case conflicts with the decisions of this Honorable Court and the federal courts of appeal. Petitioner's arguments in its petition are not new and its contentions are not meritorious. Throughout its petition, petitioner continues to fail to recognize that this case solely involves the question of what was the intent of the California

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[1]Unless otherwise stated, all statutory references are to the Revenue and Taxation Code.

[2]Nothing in the recent decisions of this Honorable Court in *Japan Line, Ltd., et al. v. County of Los Angeles* (1979) 441 U.S. 434, 99 S. Ct. 1813, 60 L. Ed. 2d 336, *Complete Auto Transit, Inc. v. Brady* (1977) 430 U.S. 274, 97 S. Ct. 76, 51 L. Ed. 2d 326 and *Moorman Mfg. Co. v. Bair* (1977) 437 U.S. 267, 98 S. Ct. 2340, 57 L. Ed. 2d 197, indicates that the Commerce Clause would be offended by this tax on petitioner.

Legislature when it enacted the particular tax exemption statutes in issue herein. The petition seeks to reargue petitioner's contentions which were fully considered and rejected by the Court of Appeal. In disagreeing with the Court of Appeal's conclusions and seeking a reversal of its decision, petitioner boldly avers that the Court of Appeal incorrectly stated the law. Such a contention is obviously groundless.

Furthermore, there is absolutely no inconsistency between the Opinion of the Court of Appeal and any other decision of this state or the United States or with Respondent California State Board of Equalization's ("the Board") own regulations interpreting the tax exemption statutes in issue herein. Indeed, the only case which has interpreted these particular statutes is *Union Oil Co. v. State Board of Equalization* (1963) 60 Cal. 2d 441, 456, which is entirely consistent with the Court of Appeal's opinion herein and was in fact cited by the Court of Appeal as authority supporting denial of the exemption herein. Interestingly, petitioner fails to refer to *Union Oil* in its discussion of inconsistency of decisions or anywhere else in its petition. The reason is evident. Further discussion of *Union Oil* will be made *infra*.

Moreover, although petitioner appears to be arguing to the contrary, the case of *People v. Weeren* (1980) 26 Cal. 3d 654 is not before this Honorable Court in this proceeding. Nevertheless, "the Board" will show that the Court of Appeal decision herein is consistent with the California Supreme Court's interpretation in *Weeren* of the California Legislature's intent in 1949 when it enacted both California Revenue and Taxation Code section 6368 (tax exemption statute in issue herein) and California Government Code sections 170-172 (describing the boundaries of California. As stated previously, it is this intent of the California Leg-

islature which is in issue herein, not any constitutional power to tax.

Finally, "the Board" respectfully submits that the Court of Appeal correctly disposed of the issues of this case and correctly concluded that the transportation of passengers upon the vessel "S.S. Catalina" between the Port of Los Angeles and the harbor of the City of Avalon on Catalina Island, both being points within the County of Los Angeles, was not interstate or foreign commerce within the meaning of the tax exemption provisions of California Revenue and Taxation Code sections 6368 and 6368.1. As there is no federal question to be resolved, there is absolutely no necessity for a writ of certiorari to the United States Supreme Court.

Statement of Facts.

The facts with which we are concerned are substantially uncontroverted and are contained in the "Stipulation of Facts" filed on February 9, 1978 (included in the Appendix herewith) which are summarized below.

During the period in question from January 1, 1963 through December 31, 1970 (hereinafter called "audit period"), the activities of petitioner were limited to the transportation of passengers upon the vessel known as the "S.S. Catalina" between the port of the City of Los Angeles and the harbor of the City of the Avalon on Santa Catalina Island. It is to be noted that *both the City of Los Angeles and the harbor of the City of Avalon are located within the County of Los Angeles, State of California.* (Gov. Code, § 23119.) Petitioner's operations were regulated *solely* by the State of California through its Public Utilities Commission. No United States mail, interstate freight nor interline passengers were carried on the 26 miles — two hours voyage between the aforesaid two points. A minority of the pas-

sengers transported by petitioner on the S.S. Catalina on a minority of voyages were part of group package tours paid for and operated by out-of-state travel agents. (Stipulation, §§ 4-6).

During the audit period, petitioner made no payments under the provisions of the California Sales and Use Tax Law with respect to either the lease payments or for the purchase of parts and materials in the repair and maintenance of the vessel, or for charges for labor or services rendered in respect thereto. (Stipulation, § 8).

On March 4, 1971, the Board issued to petitioner a notice of determination covering the audit period based upon the fact that "the Board" determined that petitioner's operation of the S.S. Catalina did not come within the exemption qualifying provisions of Revenue and Taxation Code sections 6368 and 6368.1. (Stipulation, §§ 9-10.) Consequently, a tax was assessed measured by petitioner's bareboat charter lease payments, the cost of tangible personal property purchased by petitioner which became a component part of the S.S. Catalina in the course of repairing, cleaning, altering or improving. (Stipulation, §9.)

On March 10, 1971, MGRS filed a petition for redetermination on the ground that the operation of the S.S. Catalina came within the exemption provisions of Revenue and Taxation Code sections 6368 and 6368.1 (Stipulation, §11.)

On December 28, 1973, "the Board" issued to MGRS an adverse notice of redetermination. After paying under protest the amount set forth in the notice of redetermination, MGRS filed a claim for refund on March 15, 1974. The claim was denied in the amount of $28,812.04 on May 1, 1974. Thereafter, this action was commenced to recover said amount. (Stipulation, §§ 13-17.)

ARGUMENT.

THE CALIFORNIA COURT OF APPEAL CORRECTLY CONCLUDED THAT PETITIONER DID NOT SUSTAIN ITS BURDEN OF PROVING THAT IT QUALIFIED FOR THE EXEMPTION.

A. No Federal Question Is Presented by This Petition.

It must be reemphasized that the question in this case is what was the intent of the California Legislature in enacting the tax exemption provisions of sections 6368 and 6368.1. This case does not involve the power to tax interstate or foreign commerce. It does not involve questions under limited liability statutes or under criminal statutes or questions of jurisdiction. It involves merely a California sales and use tax exemption and whether such an exemption was intended to encompass the activities of the petitioner. At page 3 of its Opinion[3] it is evident that the Court of Appeal recognized the limited issue before it.

> "The issue before us does not involve any question of the authority of the state or of Congress to regulate or otherwise legislate concerning respondent's activity. No federal law is being disputed. The California statute impinges on no federal legislation or regulation. The respondent does not dispute the power or authority of California to legislate in this field."

As was aforementioned, the constitutionality of the tax herein is undisputed. There is no evidence that the imposition of the sales and use tax herein in any way conflicts with any federal rule or regulation governing the activities of petitioner. There is no evidence that the imposition of the tax on petitioner in fact interferes with or substantially affects directly or indirectly the commerce of any sister state

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[3]A copy of the Court of Appeal Opinion is included in the Appendix hereto.

or foreign nation. Indeed, without the exemption provided in sections 6368 and 6368.1 the activities of petitioner would be fully taxable by "the Board". Accordingly, no federal question is presented by this petition.

B. Uniformity of Decisions Has Been Maintained by the Court of Appeal.

It is in light of the limited issue of this case that petitioner's contention that conflicts have been created by the Opinion of the Court of Appeal must be read.

1. The Effect of the Weeren Case.

Petitioner refers to the *Weeren* case repeatedly in its petition. (Petition, pp. 1, 2, 15, 16.) Unfortunately, it appears that petitioner has misread *Weeren*. Contrary to petitioner's assertions at page 2 of its petition, the California Supreme Court did not extend the boundary of California in violation of the ruling in *United States v. California* (1965) 381 U.S. 139, 85 S. Ct. 1401, 14 L. Ed. 2d 296. Clearly, the California Supreme Court followed *United States v. California:*

> "Here, consistent with the high court's conclusion in *California II*, we determine only that Santa Barbara Channel is outside California's boundaries *for purposes of federal law*, and that California's boundaries are those which are established under the Act as interpreted in California II. The channel is thereby excluded from California's boundaries. It follows that when defendants committed the acts for which they were convicted, they were not within California's inland waters. . . .
>
> We agree with the People's assertion that federal law does not prohibit California's assertion of penal jurisdiction over defendants even though at the time of their commission of the charged offenses they acted outside of California's territorial limits as defined for federal purposes." *People v. Weeren, supra*, 26 Cal. 3d 654, 666. (Emphasis in Original).

The conviction of the fisherman in *Weeren* was upheld not because the criminal activities were held to have occurred within California's boundaries but because in matters affecting its legitimate interests a state may regulate the conduct of its citizens upon the high seas where no conflict with federal law is presented. *Skiriotes v. Florida* (1941) 313 U.S. 69, 77, 61 S. Ct. 924, 85 L. Ed. 1193. *Weeren* goes no further.

For purposes of the instant case, the analysis of the California Supreme Court in *Weeren* of the intent of the California Legislature in 1949 when it enacted both section 6368 and California Government Code sections 170-172 is particularly enlightening and supports "the Board's" position herein.

As stated previously, the intent of the California Legislature in enacting sections 6368 (in 1949) and 6368.1 (in 1965) of the Revenue and Taxation Code is the issue of this case. In *Weeren*, the California Supreme Court stated the following with respect to the California Legislature's intent in 1949:

> "The People of California have purported to describe their own boundaries both constitutionally and legislatively. Both the 1849 and 1879 Constitutions in article XXI, section 1, described the California sea boundary as extending 'three English [i.e., nautical] miles' into the Pacific Ocean, running 'in a northwesterly direction and following the direction of the Pacific Coast . . . Also, including all the islands, harbors, and bays along and adjacent to the coast.' (Italics added; see present art. III § 2.)
>
> To implement the foregoing constitutional provision the Legislature in 1949 enacted Government Code section 170 which recites: 'To give greater precision to the [constitutional description], it is hereby declared that the [sea] . . . boundary . . . runs and has in the

past run three English nautical miles oceanward of lines drawn along the outer sides of the outermost of the islands, reefs, and rocks along and adjacent to the mainland and across intervening waters; . . .' (Italics added.)

Section 171, in turn, provides that all water between the mainland and the island-encircling lines described in section 170 'are declared to be and to have been in the past inland waters of the State.' (Italics added.) The current article III, section 2, of the Constitution, which was adopted in 1972 to replace the 1849-1879 description, declares that the state's boundaries 'are those stated in the Constitution of 1849 as modified pursuant to statute.' (Italics added.)

All parties concede that the Santa Barbara Channel, including the position at which the Comanche was boarded, is 'inland waters under the current state constitutional and statutory language. Must these state declarations yield to the preeminence of federal legislative and judicial expression?'' *People v. Weeren, supra,* 26 Cal. 3d 654, 660-661. (Emphasis added.)

Further, in rejecting the defendants' contention that the violations in issue, which occurred in Santa Barbara Channel, occurred beyond the traditional territorial limits of California, the California Supreme Court stated:

''. . . *The completed violations in the case before us occurred well within the state boundaries as defined by our state Constitution and statutes*. (Cal. Const., art. III, § 2; Gov. Code, §§ 170-171, all supra.) These are the limits to which the Legislature implicitly intended to extend California's criminal laws, including Fish and Game Code section 2000. As we have observed, California's territorial boundaries and, therefore, the extent of its criminal jurisdiction are restricted when they conflict with federal and international law. The factual record before us presents no such conflict.''

People v. Weeren, supra, 26 Cal. 3d 654, 669-670. (Emphasis added.)

Clearly, in the California Legislature's mind in 1949 when it enacted in the *same session,* both Government Code sections 170-172 and Revenue and Taxation Code section 6368, the boundaries of California included the Santa Catalina Channel, and thus any water transportation between Los Angeles and Avalon was considered to be solely *intra*-state in nature. Logically, it must be concluded that the California Legislature did not consider activities such as petitioner's to constitute interstate or foreign commerce within the purview of sections 6368 or 6368.1. The sections must be construed in harmony with the other California statutory provisions. As the California Supreme Court stated in the very recent decision of *International Business Machines v. State Board of Equal.* (1980) 26 Cal. 3d 923, 932:

> "... It is, however, 'an established rule of statutory construction that similar statutes should be construed in light of one another. ... '[A]pplication of the rule that statutes in pari materia should be construed together is most justified, and light from that source has the greatest probative force, in the case of statutes relating to the same subject matter that were passed or approved or take effect on the same day.' " (*People v. Caudillo* (1978) 21 Cal. 3d 562, 585.)"

As the issue of this case involves the intent of the California Legislature, it is evident that the Court of Appeal's Opinion herein is consistent with the analysis thereof in *Weeren* and should be sustained.

2. The Court of Appeal Opinion Is Consistent With the Union Oil Case — the Only Other Case Analyzing the Tax Exemption Statutes in Question.

The instant case does not involve a *federal* law. It involves merely *California* Sales and Use Tax Statutes which permit

an exemption from tax under certain specified conditions. It must be kept in mind that in construing an exemption statute, the applicable rule is that since tax exemptions are solely a matter of legislative grace, they are to be strictly construed against the taxpayer. *Santa Fe Transp. v. State Board of Equal.* (1959) 51 Cal. 2d 531, 593; *Coast Elevator Co. v. State Bd. of Equalization* (1975) 44 Cal. App. 3d 576, 587; *Western Contracting Corp. v. State Board of Equalization* (1974) 39 Cal. App. 3d 341, 349; *Hotel Del Coronado Corp. v. State Board of Equalization* (1971) 15 Cal. App. 3d 612, 617. Any and all doubt must therefore be resolved against the right to the exemption. *Standard Oil Co. v. State Board of Equalization* (1974) 39 Cal. App. 3d 765, 769-770. If an interpretation of the statute is reasonable in disallowing the exemption, the construction must be adopted, for it "is of no moment that the statute may be ambiguous, or that a contrary construction might also be reasonably permissible." *Hospital Service of California v. City of Oakland* (1972) 25 Cal. App. 3d 402, 406.

The Court of Appeal's decision that petitioner's activities were not interstate or foreign commerce within the meaning of the sections 6368 and 6368.1 is a strict, yet reasonable construction of the exemption and does not conflict with any other reported decision of this or any court.

As was stated previously, the only other case which has interpreted the exemption statutes in question herein is *Union Oil Co. v. State Bd. of Equal.* (1963) 60 Cal. 2d 441. *Union Oil* is completely consistent with the Court of Appeal's Opinion and was in fact cited therein as authority supporting denial of the exemption.

In rejecting petitioner's contentions that it qualified for the exemption because some of its passengers are passengers in interstate or foreign commerce, the Court of Appeal correctly stated the *relevant* law at pages 9-10 of its Opinion:

"In addition to the 'high seas' argument, respondent [petitioner herein] claims that some of its passengers are passengers in interstate or foreign commerce. This is based on the stipulation that a minority of the total passengers on a minority of voyages were parts of a group package tours paid for and operated by out-of-state travel agents. This argument may be dismissed as de minimis. In a suit for tax refund, the burden of proof rests upon the party seeking the refund. He must show not only that the tax assessment was in error but also prove sufficient facts upon which a correct assessment can be made. (*People v. Schwartz* (1947) 31 Cal. 2d 59, 64-66; *Sunshine Art Studies of California, Inc. v. State Bd. of Equalization* (1974) 39 Cal. App. 3d 223, 230-231.) In order to qualify for the claimed exemption of section 3638 [6368] it was respondent's burden to prove that the principal use of the watercraft was transportation for hire in interstate or foreign commerce. A minority of the passengers on the minority of the trips (whatever that may mean), does not prove that the principal use of the vessel was in interstate commerce or that a principal use was in transporting such types of passengers. (*Union Oil Co. v. State Bd. of Equal.* (1963) 60 Cal. 2d 441, 456-457.) To the contrary, it infers that on infrequent occasions some few passengers were sightseers or tourists from out of state. There is no proof of any interstate tourist business or negotiations therefor conducted by respondent. Neither is there any proof that respondent served as some sort of connecting passenger carrier between two interstate carriers. Admittedly, 'there is no single concept of interstate commerce . . .' (*McLeod v. Threlkeld, supra,* 319 U.S. 491, 495.) Also, we recognize that almost any local activity which may have only a remote and tenuous relationship with travel or other interstate commerce can be said to affect interstate commerce,

thus enabling Congress to regulate it in order to promote some publicly accepted and judicially recognized interest (e.g. see *Wickard v. Filburn* (1942) 317 U.S. 111.) But neither Congress nor the State have so classified respondent's activity. Until and unless Congress or the state so declare, the out-of-state tourist status of some few of its passengers does not truly change the local intra-state character of respondent's activity."

Furthermore, it should be noted that the above statement by the Court of Appeal is consistent with the *relevant* regulation of "the Board." (Cal. Admin. Code, tit. 18, Regulation 1594(a)(2)). This regulation was upheld as a reasonable interpretation of section 6368 by the California Supreme Court in *Union Oil*, 60 Cal. 2d 441, 456-457. Cal. Admin. Code, tit. 18, Regulation 1594(a)(2) provides as follows:

"(a) GENERAL EXEMPTIONS. Tax does not apply to the sale of nor to the storage, use, or other consumption of watercraft which are used, leased to a lessee for use, or sold to persons for leasing to lessees for use for any of the following purposes:

". . . .

(2) to make voyages both in interstate or foreign commerce and voyages that are exclusively in intrastate commerce where the *principal use* of the watercraft is transportation for hire in interstate or foreign commerce. The tax applies with respect to watercraft making voyages both in interstate or foreign commerce and voyages that are exclusively in intrastate commerce where the *principal use* of the watercraft is in intrastate commerce. (Emphasis added.)

As the Court of Appeal correctly noted, at page 10, the Stipulation of Facts in this case provides that a minority of passengers on a minority of trips were part of group package tours paid for and operated by out-of-state travel agents.

The Court of Appeal analyzed the relevant law set forth in *Union Oil* and correctly concluded that such facts do *not* prove that the principal use of the S.S. Catalina was in interstate or foreign commerce or that a *principal* use was in transporting such types of passengers.

It is evident that the Court of Appeal decision in this case is consistent with the only other case analyzing the tax exemption statutes in question and with the regulations of "the Board" as well. Petitioner has cited to this Honorable Court nothing in opposition to the above.

3. No California, Federal or United States Supreme Court Case Has Been Cited by Petitioner Which Defines the Specific Activity of Petitioner to Be Interstate or Foreign Commerce.

Throughout its petition, petitioner places heavy reliance upon *Lord v. Goodall, etc.* (1880) 102 U.S. 541, 26 L. Ed. 224. The decision in that case does not provide relief to petitioner herein.

The Court of Appeal correctly noted at page 6 of its Opinion that *Lord* was not followed by the California Supreme Court in *Wilmington T. Co. v. Railroad Commission* (1913) 166 Cal. 741, nor by this Honorable Court in *Wilmington Transportation Company v. Railroad Commission of California* (1915) 236 U.S. 151, 35 S. Ct. 276, 59 L. Ed. 508, which affirmed the California Supreme Court's decision in 166 Cal. 741.

In Wilmington, the California Supreme Court in discussing *Lord* stated the following:

> ". . . The conclusion that the limited liability law was applicable was undoubtedly correct for the reason stated in the later case of *Lehigh Valley R.R. Co. v. Pennsylvania*, 145 U.S. 192, [36 L. Ed. 672, 12 Sup. Ct. Rep. 806], but in view of what is said in the latter case as to the true ground of decision in the *Lord* case,

> *we do not feel bound to follow the views expressed in the Lord case as to what constitutes commerce with foreign nations.*" *Wilmington et al. v. Railroad Comm., supra,* 166 Cal. 741, 746 (Emphasis added.)

This Honorable Court affirmed the California Supreme Court's decision in *Wilmington* and was very careful not to state that it agreed with *Lord.*

> "Relying upon *Lord v. Steamship Co.,* 102 U.S. 541, the plaintiff in error contends that transportation over the high seas is 'commerce with foreign nations' in the constitutional sense. (See *Lehigh Valley R.R. v. Pennsylvania,* 145 U.S. 192, 203; the Abby Dodge, 223 U.S. 166, 176.) *But if it be assumed* for the present purpose that the power of Congress extends to the subject of this controversy, the fact remains that the power has not been exercised . . . It is not necessarily determinative that the vessels in the course of the transportation in question pass beyond the boundary of the State. See *The Hamilton,* 207 U.S. 398, 405." *Wilmington Transportation Co. v. Railroad Commission, et al., supra,* 236 U.S. 151, 153-154. (Emphasis added.)

The Court of Appeal correctly stated at pages 3-5 that this Honorable Court in *Lehigh Valley R. Co. v. Commonwealth of Pennsylvania* (1891) 145 U.S. 192, 203, 12 S. Ct. 806, 36 L. Ed. 672, explained the ground for the decision in *Lord* as being the right of Congress to limit liability under its maritime jurisdiction. Had *Lord* been seen by this Honorable Court as standing for the proposition put forth herein by petitioner, the case would have been decided differently.

Moreover, petitioner's reliance upon *Cornell Steamboat Co. v. U.S.* (1943) 321 U.S. 634, 64 S. Ct. 758, 88 L. Ed. 978, was properly rejected by the Court of Appeal at pages

5 and 6 because of the dissimilarity of the facts with the instant case.

Finally, nothing in the two related cases of *United States v. California* (1947) 332 U.S. 19, 67 S. Ct. 1658, 91 L. Ed. 1889, and *United States v. California* (1965) 381 U.S. 139, 85 S. Ct. 1401, 14 L. Ed. 2d 296 holds that all activities beyond the territorial waters is necessarily interstate or foreign commerce. Commerce among the States is not a technical legal conception but a practical one, drawn from the course of business. *Swift and Company v. U.S.* (1904) 196 U.S. 375, 398, 25 S. Ct. 276, 49 L. Ed. 518. (Justice Holmes speaking for a unanimous court.)

In all, petitioner is unable to refer the courts below or this Honorable Court to any case which has held that the activity of petitioner is interstate or foreign commerce.

C. The Specific Activity of Petitioner at the Place Where It Occurred Has Not Been Declared Interstate or Foreign Commerce by Any State or Federal Statute.

Petitioner cites no authority contrary to the above in its petition. In fact, it should be noted (and petitioner does not disagree) that the definition of "interstate or foreign commerce" for purposes of water transportation under the Interstate Commerce Act would *exclude* the voyage between Los Angeles and Avalon. Furthermore, no exemptions under the Act are provided for such a voyage between two points within the same state.

49 United States Code section 902(i) states:[4]

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[4]It is to be noted that effective September 14, 1978, 49 United States Code section 902(i) was revised and renumbered as 49 United States Code section 1054(a)(1)-(3). The revision does not alter the above definition.

"The term 'interstate or foreign transportation' or 'transportation in interstate or foreign commerce,' as used in this chapter, means transportation of persons or property —

"(1) wholly by water from a place in a State to any other State, whether or not such transportation takes place wholly in the United States;

"(2) partly by water and partly by railroad or motor vehicle, from a place in a State to a place in any other State; except that with respect to such transportation taking place partly in the United States and partly outside thereof, such terms shall include transportation by water only insofar as it takes place from a place in the United States to another place in the United States;

"(3) wholly by water, or partly by water and partly by railroad or motor vehicle, from or to a place in the United States to or from a place outside the United States, but only (a) insofar as such transportation by rail or by motor vehicle takes place within the United States, and (b) in the case of a movement to a place outside the United States, only insofar as such transportation by water takes place from any place in the United States to any other place therein prior to transshipment at a place within the United States for movement to a place outside thereof, and, in the case of a movement from a place outside the United States, only insofar as such transportation by water takes place from any place in the United States to any other place therein after trans-shipment at a place within the United States in a movement from a place outside thereof."

Subdivision (1) is inapplicable because no state other than California is involved. Subdivision (2) is inapplicable since railroad or motor vehicle transportation is not present. Subdivision (3) has no application since the destination is not outside the United States and the transshipment of persons or property is not present.

The water transportation between Los Angeles and Avalon involves the movement between two points of *one* county of the State of California and consequently does not come within the express provisions of the Interstate Commerce Act. As stated in the Stipulation of Facts (¶ 5) petitioner conducted its activities "pursuant solely to authority granted by the California Public Utilities Commission." Clearly, the activities of petitioner did not constitute interstate or foreign commerce under federal statutory law.

D. The Board's Longstanding Administrative Interpretation of Sections 6368 and 6368.1 Is Consistent With the Court of Appeal's Decision Herein and Is Entitled to Great Weight When Being Judicially Reviewed.

In administering the California Sales and Use Tax Law, "the Board" has consistently held since at least 1954 (well before the audit period) that the phrase "interstate or foreign commerce" for purposes of sections 6368 and 6368.1, was *not* intended to cover the situation where a vessel travels in part on the high seas in the course of its journey to and from California ports.

In 1954, "the Board" issued Sales Tax Counsel Ruling[5] 600.0080 as follows: "The fact that vessels travel in part on the high seas in the course of their journeys to and from California ports does not exempt them under Section 6368 from California use tax as being used in interstate or foreign commerce."

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[5]Sales Tax Counsel Rulings are issued by the Board in response to specific requests from taxpayers. Short abstracts of the rulings regularly appear in Commerce Clearing House, Prentice Hall and the Business Taxes Law Guide in order that taxpayers in the same field may be given guidance.

In 1971, "the Board" issued Sales Tax Counsel Ruling 600.0050 as follows:

> "A steamship company, not regulated by the Interstate Commerce Commission, carrying no interstate passengers or freight from California to Catalina Island through the high seas was not exempt from the sales and use tax on rental receipts or purchases of parts and material to maintain the vessels, since the operation was a local activity and did not qualify for the exemption for watercraft transporting persons or property in interstate commerce. Even though a portion of the journey was on the high seas, the transportation did not occur in interstate commerce."

"The Board's" reasoning is basically that the mere fact that high seas are traveled upon as a means to journey between two points within the same county of California is insufficient in itself to render the otherwise completely "local" activity as being in interstate or foreign commerce for purposes of the exemption sections. As the phrase "interstate or foreign commerce" is susceptible to various interpretations under various statutes, "the Board's" interpretation for purposes of the particular statutes in question herein is reasonable and is entitled to the "great weight" standard of judicial review. *Culligan Water Conditioning v. State Board of Equalization* (1976) 17 Cal. 3d 86, 92-93.

"The Board" is a constitutional body (Cal. Const. art. XIII, § 9) authorized by the Legislature to administer and enforce the sales and use tax law, Revenue and Taxation Code section 7051, et seq., with power to adopt rules and regulations. *American Distilling Co. v. State Board of Equalization* (1942) 55 Cal. App. 2d 799, 805. In connection with these powers, the Legislature has conferred a degree of discretion on "the Board." So long as that discretion

is executed within the scope of the controlling statute, it will not be disturbed by the court; and unless "the Board's" action can be characterized as arbitrary, capricious, or patently unreasonable, the weight of the authorities enjoins any further incursion by the court into "the Board's" exercise of the authority delegated to it by the Legislature. *Henry's Restaurants of Pomona, Inc. v. State Board of Equalization* (1973) 30 Cal. App. 3d 1009, 1020-1021; approved in *Culligan Water Conditioning v. State Board of Equalization, supra,* 17 Cal. 3d 86, 92-93.

If "the Board" has promulgated a formal regulation determining the proper classification for the imposition of the sales or use tax and the regulation has been challenged in an action for refund of the tax paid, the proper scope of reviewing said regulation would be one of limited judicial review. *Culligan Water Conditioning v. State Bd. of Equalization, supra,* 17 Cal. 3d 86, 92; *Henry's Restaurants of Pomona, Inc. v. State Bd. of Equalization, supra,* 30 Cal. App. 3d 1009, 1020-1021; *Mission Pak Co. v. State Bd. of Equalization* (1972) 23 Cal. App. 3d 120, 124-125; *Carmona v. Division of Industrial Safety* (1975) 13 Cal. 3d 303, 309-310; *Pitts v. Perluss* (1962) 58 Cal. 2d 824, 834-835.

Where there is an administrative interpretation of a statute, such interpretation will be accorded great weight by the court and will be followed if not clearly erroneous. *Select Base Materials, Inc. v. Bd. of Equalization* (1959) 51 Cal. 2d 640, 647; *Coca-Cola Co. v. State Bd. of Equalization* (1945) 25 Cal. 2d 918, 921.

If reasonable minds may well be divided as to the wisdom of "the Board's" action, its action is conclusive, or stated another way, if there appears to be some reasonable basis for the administrative classification, a court will not substitute its judgment for that of "the Board." The burden of proof of invalidity rests with the taxpayer. *Rible v.*

Hughes (1944) 24 Cal. 2d 437, 445; *Action Trailer Sales, Inc. v. State Board of Equalization* (1975) 54 Cal. App. 3d 125, 132-133.

The contemporaneous administrative construction and interpretation of the Constitution, the statutes and its own regulations by "the Board" is entitled to great weight, and the courts generally will not depart from such construction and interpretation unless it is clearly *erroneous* or unauthorized. Such construction and interpretation is a question of law, the ultimate resolution of which rests with the courts. *Coca-Cola Co. v. State Board of Equalization, supra,* 25 Cal. 2d 918, 921; *Rivera v. City of Fresno* (1971) 6 Cal. 3d 132; *Culligan Water Conditioning v. State Board of Equalization, supra,* 17 Cal. 3d at 93; *Carmona v. Division of Industrial Safety, supra,* 13 Cal. 3d 303, 310; *Merrill v. Department of Motor Vehicles* (1969) 71 Cal. 2d 907, 917.

An administrative interpretation which has existed for a number of years is entitled to even greater consideration since it "suggests legislative acquiescence." *Great Western Financial Corp. v. Franchise Tax Board* (1971) 4 Cal. 3d 1, 7.

The interpretation of "the Board" herein becomes even more reasonable when the Stipulation of Facts are closely scrutinized. It is undisputed that petitioner's activity involved no contact with any other state or foreign country. No United States mail, interstate freight or interline passenger was carried on the S.S. Catalina. Petitioner was not regulated by any federal, foreign or *non* California governmental body. Clearly, "the Board's" interpretation of the exemption statutes, with which the Court of Appeal concurred, reaches a reasonable result rather than the absurd one urged by petitioner herein. "The Board's" interpretation and Court of Appeal's decision result in a strict yet

reasonable construction of these statutes which is exactly what the law requires. Accordingly, it must be held that the Court of Appeal correctly concluded that petitioner's burden of proving it qualified for the exemption has not been sustained.

Conclusion.

There is no federal question presented by this petition. There is no question as to the power of "the Board" to tax petitioner's activities. No questions of jurisdiction to tax have been raised. No evidence has been presented by petitioner that "the Board's" imposition of the tax on the activities of petitioner in fact conflicts with any federal rule or regulation governing petitioner's activities or interferes with or substantially affects directly or indirectly the commerce of some sister state or foreign nation.

This case merely involves a California sales and use tax exemption and whether such exemption was intended by the California Legislature to encompass the activities of petitioner. Although none of the facts and points raised in this brief *alone* conclusively prove whether the California Legislature intended to encompass activities such as petitioner's when it enacted the exemption statutes, *taken together* they strengthen the conclusion reached by the Court of Appeal that the Legislature did *not* intend to do so.

From the foregoing, it is evident that the petition is not meritorious. Accordingly, "the Board" respectfully requests that the relief sought by petitioner be denied.

Respectfully submitted,

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APPENDIX.

In the Court of Appeal of the State of California. Second Appellate District, Division Two.

M.G.R.S., Inc., a California corporation, Plaintiff and Respondent, vs. California State Board of Equalization, Defendant and Appellant. 2 Civ. No. 56238, (Super. Ct. No. C96419.)

Filed: March 7, 1980.

APPEAL from a judgment of the Superior Court of Los Angeles County. William P. Hogoboom, Judge. Reversed with directions.

George Deukmejian, Attorney General, and Arthur C. DeGoede, Edmond B. Mamer, Philip C. Griffin, Lawrence K. Keethe, and Jeffrey M. Vesely, Deputy Attorneys General, for Defendant and Appellant.

James H. Lyons and J. Terence Lyons, for Plaintiff and Respondent.

NATURE OF APPEAL:

Appellant, State of California, through its State Board of Equalization (Board) appeals from the judgment of the Superior Court exempting respondent M.G.R.S., Inc. (MGRS) from payment of sales or use tax.

ISSUE:

The appeal presents the simple question: "Is the transportation of passengers upon the vessel 'S.S. Catalina' between the port of Los Angeles and the harbor of the City of Avalon on Catalina Island, both being points within the County of Los Angeles, interstate commerce within the meaning of Revenue and Taxation Code sections 6368.1?"

OUR DECISION:

We hold that it is not and we reverse.

FACTS:

The parties submitted the case to the trial court upon a written stipulation of facts. MGRS is a California corporation whose business was limited to transportation of passengers between the Port of Los Angeles and Avalon on Catalina Island. The distance between the two points is approximately 26 miles. Both points are located within the County of Los Angeles and the State of California. The trip takes approximately two hours one way. MGRS was regulated solely by the California State Public Utilities Commission. No United States mail, interstate freight nor interline passengers were carried on the trip between the two points. On a few occasions, a minority of the passengers transported were part of group package tours paid for and operated by out-of-state travel agents. The Board imposed certain taxes under the Use and Sales Tax Law. MGRS paid under protest and thereafter sought recovery on the basis that its activity was excluded because it was engaged in interstate commerce and the law which otherwise imposed the tax on such business excluded those which were in interstate commerce.

THE STATUTORY PROVISIONS:

California imposes a Sales and Use Tax on the type of activity in which MGRS is engaged. (''California Use Tax Law'', Rev. & Tax. Code, div. 2, part 1, §§ 6001, et seq.) Revenue and Taxation Code sections 6368 and 6368.1,[1] specifically exempt receipts from the use or sales and lease for such use of water craft for use in interstate or foreign commerce.

DISCUSSION:

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[1]References hereafter to sections 6368 and 6368.1 are to the Revenue and Taxation Code.

The issue before us does not involve any question of the authority of the state or of Congress to regulate or otherwise legislate concerning respondent's activity. No federal law is being disputed. The California statute impinges on no federal legislation or regulation. The respondent does not dispute the power or authority of California to legislate in this field. Respondent instead asserts that it seeks to have enforced the law as written and to be excluded from the tax by reason of its claim that it, respondent, is engaged in interstate commerce. However, we conclude that under the facts at bench, respondent's contentions are reduced to the argument that respondent's activity could possibly be defined as being interstate commerce and therefore exempting respondent from the tax. The exemption, however, applies only to vessels which actually are engaged in or used in interstate commerce, not upon activity which could be so defined. The specific activity of respondent at the place where it occurred has not been declared interstate commerce by any state or federal statute. Nor has it been so defined by any California Supreme Court or appellate case or any United States Supreme Court decision.

Some cases relied upon by respondent at first blush seem to hold that similar conduct has been described as interstate commerce. Examination of such cases discloses totally dissimilar facts upon which they can be distinguished. More importantly, other California and United States Supreme Court cases have demonstrated that this type of activity present at bench is not interstate commerce.

Relying upon language used in *Lord v. Goodall etc. S.Co.* (1880) 102 U.S. 541, respondent asserts that it is engaged in interstate or foreign commerce because its vessel the S.S. Catalina, like the vessel Ventura in *Lord*, traveled upon the "high seas", i.e. beyond the territorial or three-mile seaward limit of the State of California's shoreline. But *Lord*

is of little comfort to respondent. In *Lord* the steamship Ventura transported passengers and cargo between San Francisco and San Diego. On one such voyage the vessel was lost. In affirming the applicability of the federal statute which limited liability, the United States Supreme Court stated that in its voyage the vessel traveled 480 miles and that the vessel went out of California and out of the United States as well, far out onto the Pacific Ocean. The court declared that the vessel entered on navigation which was "connected with other nations." It said, "In every just sense, therefore, she was, while on the ocean, engaged in commerce with foreign nations, and as such she and the business in which she was engaged were subject to the regulating power of Congress." (*Id.* at p. 544.)

However, the statement in *Lord* that the federal statute was applicable because the ship was engaged in interstate commerce and that this was because of its travel on the Pacific Ocean, was expressly rejected and repudiated and the case expressly disapproved on this ground in both the state Supreme Court and the United States Supreme Court opinions in the later case of *Wilmington T. Co. v. Railroad Commission* (1913) 166 Cal. 741, and in *Wilmington Transportation Company v. Railroad Commission of California* (1915) 236 U.S. 151, affirming the Supreme Court of California's decision in 166 Cal. 741. As explained in both decisions, *Lord* was not a case of determining the existence of interstate commerce but instead involved the initial authority of Congress to enact legislation relative to and applicable to all ships in navigation, i.e. the right to limit liability under the maritime jurisdiction. There was present in *Lord* an act of Congress which applied to the activity involved. That activity was the loss at sea which caused the operation of the statute. Both the state and the United States Supreme Court decisions in *Wilmington* recognize that that

part of the discussion in *Lord* concerning the existence of interstate commerce had earlier been renounced by the United States Supreme Court in *Lehigh Valley R. Co. v. Commonwealth of Pennsylvania* (1891) 145 U.S. 192, and in *Ex Parte Garnett* (1891) 141 U.S. 1, 12. As explained in *Garnett*, the maritime limited liability statute was applicable to vessels and ships in navigation whether engaged in interstate commerce or not. Such maritime laws apply to all vessels on all navigable waters whether the vessel is operating within or beyond the territorial waters of the state (*Butler v. Boston & Savannah Steamship Co.* (1888) 130 U.S. 527) and may be applicable or operate irrespective of the commerce clause or of the presence or absence of interstate commerce in the particular case. (*Moragne v. State Marine Lines* (1970) 398 U.S. 375.)

Respondent also relies on *Cornell Steamboat Co. v. United States* (1943) 321 U.S. 634. In defining interstate commerce for the purpose of commerce by water and the regulation thereof, the court in *Cornell* held that part of the Interstate Commerce Act regulating certain common carriers by water apply to vessels traveling between two points in the same state but which pass through the waters of another state. But present in *Cornell* were two features absent at bench. They are: (1) while en route between two points in New York, the voyage of the ship passed through the waters within the boundary of New Jersey, another state, and (2) Congress had enacted legislation covering that very type of activity which the federal government sought to regulate. Moreover, the court expressly noted that such definition did not include certain types of cases involving transportation where the terminal points are located within the same state for the purpose of removing the activity from state taxation expressly citing *Wilmington Transportation Company v. Railroad Commission of California, supra*, 236 U.S. 151.

The facts at bench are different than in *Cornell*. As stipulated, in ferrying its passengers back and forth in this narrow channel, MGRS in no way contacted any activity of any other state or foreign country. By crossing the channel, respondent MGRS entered the territory of no other state, passed no other state or foreign country, nor entered the waters thereof. It carried no United States mail, interstate freight or interline passengers. It did nothing that required regulation by the federal government. It was not regulated by any federal, foreign or non-California governmental body. Comparing these facts to the facts in *Wilmington* is instructive. In *Wilmington* the state sought to control the rates charged for carrying passengers and cargo from San Pedro to Avalon, the same route and activity as present at bench. Holding that the activity was not exempt from state control on the claimed basis that it was interstate commerce and subject only to congressional control, the California Supreme Court said: "Vessels plying between San Pedro and Avalon cross the high seas for the sole purpose of getting from one point in Los Angeles County to another point in the same county. They do not touch at any other port, either of the United States or of any foreign country. They do not transfer their passengers or freight to any other vessel or receive the same from any other vessel in their course. They do not on the voyage take on or put off any article of commerce. While a portion of the voyage is on the high seas, the navigation thereof is merely incidental to the real purpose of the voyage, which is to ply between two ports, both of which are located in the same county in this state." (*Wilmington T. Co. v. Railroad Commission, supra*, 166 Cal. 741, 743.)

In affirming and approving this decision, the Supreme Court of the United States agreed adding its language as follows:

"We are not here dealing with the case of property which is in course of continuous transportation to another State or to a foreign country. [Citations.] It must be assumed upon this record that the State claims the right to exercise its authority only as to transportation between the mainland and the island and solely with respect to such shipments over this route as are local to the State, both as to the beginning and the end of the transportation. There is no passage through the territory of another State; the transportation, in its entire course, is subject to a single authority — either that of Congress or that of the State — and the latter would yield to the exercise of the former. The sovereignty of no other jurisdiction is encountered. It is plainly of importance to the people of the State that this local traffic should be carried upon reasonable terms; and if, in the case of a ferry, a State may protect its people from extortion although the ferriage is to the shore of another State, there is in our judgment no ground for saying that where the transportation is between two places in the same State it is less a subject for local action, in the absence of Federal interposition, because the voyage is over a stretch of open sea. Congress has not attempted to intervene, and we find no basis for the conclusion that the subject is one which must be deemed to be wholly free from regulation unless Congress deals with it. On the contrary, it is precisely of that local character which permits it to be left appropriately to the care of the State." (Emphasis added.) (*Id.* at p. 156.)

Both appellant and respondent devote much discussion to the issue of the territorial boundaries of California and whether or not the state has the power or authority to "regulate beyond its territorial jurisdiction." Respondent claims that the two related cases of *United States v. California* in (1947) 332 U.S. 19 and the subsequent decision in *United*

States v. California (1965) 381 U.S. 139, are authority for the proposition that California cannot claim nor exercise authority beyond the historic three-mile limit, parallel and seaward of its coastline because such area constitutes the high seas rather than the inland waters of the state. The holdings of these cases are irrelevant for our purposes here. The existence of the official territorial limits of California is relevant only to determine the fact that the vessel here does in fact travel upon high seas and beyond the inland waters of the state.

But as indicated before, there is no dispute and we do not dispute that in its travel the S.S. Catalina traveled upon the high seas. However, the activity in issue here was not subject to congressional regulation. The result is that respondent would claim that it is by definition presently under no authority or regulation by any jurisdiction. But nothing in the companion cases of *United States v. California, supra,* holds that the State of California may not impose a use tax on the activity simply because of the definition and determination of the territorial limits in those cases, which concerned the application of the Submerged Tidelands Act. The cases do not hold that all else beyond the territorial waters of California is necessarily interstate or foreign commerce. In both of the *United States v. California* cases, there existed the conflict in the operation or claims under the interpretation of what Congress intended to grant to the states by the Submerged Tidelands Act and the interpretation of the state's statutes defining the boundaries of the State of California. Additionally, the state in those cases was a party claiming broader statutory territory than the existing statutes clearly described. No such conflict is present here. The state claims no territory or jurisdiction to control what occurs in or over the high seas per se. The state here has simply legitimately imposed a use tax not upon an interstate com-

mercial activity but on the property or use thereof by a local corporation doing an entirely local business out of one local point in California where it has its principal place of business. San Pedro, and where that business involves no more than going to another point within the same county and state.

The authority and right to impose a tax free from the claim that by definition the activity is interstate commerce, is amply supported by *Wilmington Transportation Company v. Railroad Commission of California, supra,* 236 U.S. 151, and other cases rejecting the defense of interstate commerce. (*Alaska v. Arctic Maid* (1961) 366 U.S. 199.)

Respondent also relies upon *United Air Lines v. Public Utilities Commission of Cal.* (1952) 109 F. Supp. 13 (S.D. Cal.). The federal trial court held that flights between Los Angeles International Airport and Santa Catalina Island were within the jurisdiction of the Federal Civil Aeronautics Board because the flights were over the high seas. The state claimed the right to regulate flights by requiring compliance with its local regulations. Respondent asserts that the case was reversed by the Supreme Court on "procedural grounds." Irrespective of respondent's characterization, the entire case was reversed in 346 U.S. 402, in its entirety. Thus there is no authority that transporting passengers by air from San Pedro to Catalina Island is interstate commerce which thereby insulates that activity from control by the State of California.

In addition to the "high seas" argument, respondent claims that some of its passengers are passengers in interstate or foreign commerce. This is based on the stipulation that a minority of the total passengers on a minority of voyages were parts of group package tours paid for and operated by out-of-state travel agents. This argument may be dismissed as de minimis. In a suit for tax refund the burden of proof

rests upon the party seeking the refund. He must show not only that the tax assessment was in error but also prove sufficient facts upon which a correct assessment can be made. (*People v. Schwartz* (1947) 31 Cal. 2d 59, 64-66; *Sunshine Art Studios of California, Inc. v. State Bd. of Equalization* (1974) 39 Cal. App. 3d 223, 230-231.) In order to qualify for the claimed exemption of section 3638, it was respondent's burden to prove that the principal use of the watercraft was transportation for hire in interstate or foreign commerce. A minority of the passengers on the minority of the trips (whatever that may mean), does not prove that the principal use of the vessel was in interstate commerce or that a principal use was in transporting such types of passengers. (*Union Oil Co. v. State Bd. of Equal.* (1963) 60 Cal. 2d 441, 456-457.) To the contrary, it infers that on infrequent occasions some few passengers were sightseers or tourists from out of state. There is no proof of any interstate tourist business or negotiations therefor conducted by respondent. Neither is there any proof that respondent served as some sort of connecting passenger carrier between two interstate carriers. Admittedly, "there is no single concept of interstate commerce . . ." (*McLeod v. Threlkeld, supra*, 319 U.S. 491, 495.) Also, we recognize that almost any local activity which may have only a remote and tenuous relationship with travel or other interstate commerce can be said to affect interstate commerce, thus enabling Congress to regulate it in order to promote some publicly accepted and judicially recognized interest (e.g. see *Wickard v. Filburn* (1942) 317 U.S. 111.) But neither Congress nor the state have so classified respondent's activity. Until and unless Congress or the state so declare, the out-of-state tourists status of some few of its passengers does not truly change the local intrastate character of respondent's activity.

In summary, the respondent was not doing a business in interstate commerce among the several states or between one state and other or passing through waters of another state or foreign nation. It was not carrying on any substantial part of any interstate travel. Apart from making a claim that it was plying its trade upon the high seas, respondent cannot demonstrate that its activity was genuinely and substantially engaged in interstate or foreign commerce. Admittedly, the absence of congressional control does not necessarily prove the activity is not interstate commerce. On the other hand, as in the case at bench, the lack of any evidence of any federal regulation or control, and the lack of any evidence that the imposition of the sales and use tax in any way conflicts with any federal rule or regulation governing the activity of respondent, and the lack of any evidence that the activity in fact interferes with or substantially affects directly or indirectly the commerce of some sister state or foreign state or foreign nation, all strengthen the conclusion that respondent is not engaged in interstate or foreign commerce.

The judgment is reversed and the cause remanded to the superior court with instructions to enter judgment for appellant.

NOT FOR PUBLICATION.

/s/ BEACH
BEACH, *J.*

We concur:

/s/ FLEMING
FLEMING, *Acting P. J.*
/s/ COMPTON
COMPTON, *J.*

Stipulation of Facts.

Superior Court of the State of California for the County of Los Angeles.

M.G.R.S., Inc., a California corporation, Plaintiff, vs. California State Board of Equalization, Defendant. No. C 96419.

IT IS HEREBY STIPULATED by and between plaintiff M.G.R.S., Inc., a California corporation (hereinafter called "MGRS") and defendant California State Board of Equalization (hereinafter called "Board"), through their respective counsel, that for the purposes of the herein action the following statements are true and undisputed, although not necessarily relevant, and may be treated by the Court as facts proven in open court.

1. At all times herein mentioned, MGRS was and is now a corporation duly organized and existing under and by virtue of the laws of the State of California, with its principal place of business in the County of Los Angeles.

2. The Board is a duly constituted agency of the State of California charged with the administration of the Sales and Use Tax Law.

3. The California Attorney General has an office in the City of Los Angeles, County of Los Angeles, State of California.

4. The amount in controversy between MGRS and the Board concerns the period January 1, 1963 through December 31, 1970 (hereinafter called "audit period") to which all unspecified time references relate.

5. At all times mentioned herein, plaintiff was engaged in the transportation of passengers and their baggage for hire by vessel between the Port of the City of Los Angeles and the harbor of the City of Avalon on Santa Catalina Island pursuant solely to authority granted by the California

Public Utilities Commission in Decision 59710 in Application 41589, dated February 23, 1960, as subsequently amended.

6. The duration of the one-way voyage between the two points was approximately two hours and covered a distance of 26 miles. No United States mail, interstate freight on through bills of lading, nor interline (pursuant to joint and through arrangements between MGRS and other carriers) passengers were carried on the S.S. Catalina by MGRS. Some of the passengers transported were part of group package tours arranged, paid for and operated by out-of-state travel agents. These tours originated in the following locations, among others: Vancouver, British Columbia; New York City; Flagstaff, Arizona; Sonora, Mexico; Provo, Utah; Boston, Massachusetts; Las Vegas, Nevada; Albuquerque, New Mexico; Salt Lake City, Utah; Little Rock, Arkansas; Oceanside, New York; Houston, Texas. The passengers on such out-of-state package tours represent a minority of total passengers on a minority of voyages.

7. At all times mentioned herein, MGRS leased the S.S. Catalina, a watercraft, from the Catalina Transportation Co., a California corporation, under a bareboat charter agreement whereby MGRS was responsible for the purchase of parts and materials and for the repair and maintenance of the vessel. During the audit period MGRS made regular lease payments to Catalina Transportation Co. and purchased tangible personal property which became a component part of such watercraft in the course of further construction, repairing, cleaning, altering or improving the vessel, and paid charges for labor and services rendered in respect thereto. Such tangible personal property included, among other things, paint, valves, springs, ropes and bulkheads.

8. During the audit period MGRS did not have a permit from nor an account number with the Board and made no payments under the provisions of the Sales and Use Tax Law with respect to either the bareboat charter lease payments or for the purchase of parts and materials in the repair and maintenance of the vessel, or for charges for labor or services rendered in respect thereto. MGRS purchased the tangible personal property ex-tax by furnishing its vendors with a watercraft exemption certificate at the time of sale.

9. On January 14, 1971, the Board issued to MGRS a report of a field audit covering the audit period. The report was based upon a review of the books and records of MGRS, including the general ledger, books of original entry, cash receipts and disbursements journal, purchase invoices and the lease agreements between MGRS and Catalina Transportation Co. The Board administratively determined that the operation of the S.S. Catalina by MGRS did not come within the exemption qualifying provisions of Revenue and Taxation Code Sections 6368 and 6368.1, and thus a tax was assessed measured by the bareboat charter lease payments in the amount of $274,847 and the cost of tangible personal property which became a component part of the S.S. Catalina in the course of repairing, cleaning, altering, and improving the same, and charges made for labor and services rendered in respect to such repairing, cleaning, altering, or improving, in the amount of $191,804.

10. On March 4, 1971, the Board issued to MGRS a notice of determination covering the audit period, a copy of which is attached hereto as Exhibit A and incorporated herein by reference.

11. On March 10, 1971, MGRS filed with the Board a petition for redetermination on the ground that the operation of the S.S. Catalina came within the exemption pro-

visions of Revenue and Taxation Code Sections 6368 and 6368.1.

12. On March 9, 1972, a preliminary hearing on the petition was held before Board Hearing Officer Robert H. Anderson. On September 25, 1973, a formal hearing on the petition was held before the Board en banc.

13. On December 28, 1973, the Board issued to MGRS a notice of redetermination, a copy of which is attached hereto as Exhibit B and incorporated herein by reference.

14. On January 25, 1974, MGRS timely paid under protest to the Board the amount of $30,916.73 set forth in the notice of redetermination.

15. On March 15, 1974, MGRS timely filed with the Board under the provisions of Revenue and Taxation Code Section 6902 a claim for refund of the amount paid. It requested that the penalty portion of the assessment ($2,-104.69) for failure to file tax returns be waived under Section 6592 and refunded on the ground that it was advised by its counsel and believed that it was exempt from the tax under Sections 6368 and 6368.1.

16. On May 1, 1974, the Board denied the claim for refund of MGRS in the amount of $28,812.04 and waived the penalty in the amount of $2,104.69. On June 21, 1974, the Board refunded the penalty to MGRS.

17. On August 8, 1974, MGRS timely filed this action pursuant to Revenue and Taxation Code Section 6933.

18. If the Court determines that the use of the S.S. Catalina by MGRS is "in interstate or foreign commerce" as those words are used in Revenue and Taxation Code Sections 6368 and 6368.1, MGRS is entitled to a refund in the amount of $28,812.04 plus interest thereon from January 25, 1974, as provided by Revenue and Taxation Code Section 6936. If the Court determines that the use of

the S.S. Catalina by MGRS is not "in interstate or foreign commerce" as those words are used in Sections 6368 and 6368.1, MGRS is entitled to no amount of refund.

DATED: February .... , 1978.

EVELLE J. YOUNGER, Attorney General,
PHILIP C. GRIFFIN,
RODNEY LILYQUIST, JR.,
LAWRENCE KETHE,
Deputy Attorneys General,
By LAWRENCE KETHE,
Attorneys for Defendant,
California State Board of
Equalization.

DATED: February 8, 1978.

/s/ JAMES H. LYONS
JAMES H. LYONS,
Attorney for Plaintiff
M.G.R.S., Inc.

STATE BOARD OF EQUALIZATION
DEPARTMENT OF BUSINESS TAXES
P. O. BOX 1799 SACRAMENTO, CALIFORNIA 95808

RE | PIA

EFFECTIVE DATE OF PAYMENT
MO DAY YEAR

IN REPLY REFER TO

M,G.R.S.,INC.
P.O.BOX 511
SAN PEDRO CA 90733

DATE: MARCH 4,1971

ACCOUNT NUMBER
SR AL 01-9091

NOTICE OF DETERMINATION

YOU ARE HEREBY NOTIFIED OF AN AMOUNT OF TAX, INTEREST AND PENALTY DUE FROM YOU PURSUANT TO THE SALES AND USE TAX LAW AND WHERE APPLICABLE, STATE-ADMINISTERED LOCAL SALES AND USE TAX AND DISTRICT TRANSACTIONS (SALES) AND USE TAX ORDINANCES.

	AMOUNT			
	TAX	INTEREST	PENALTY	TOTAL
AS DETERMINED 01/01/63-12/31/70	21,046.95	4187.27	2104.69	27,338.91
L-2245 B-0114				
TOTAL	21,046.95	4187.27	2104.69	27,338.91
		****PAY THIS AMOUNT		27,338.91

MONTHLY INTEREST OF 109.23 WILL ACCRUE IF NOT PAID BEFORE 04/01/71
ADDITIONAL PENALTY OF 2104.70 IF NOT PAID BY 04/03/71

PENALTY OF 10% HAS BEEN ADDED FOR FAILURE TO FILE RETURN(S).

LIABILITY DISCLOSED BY AUDIT.

INFORMATION CONCERNING TAX DETERMINATIONS

ANY PERSON AGAINST WHOM A DETERMINATION IS MADE OR ANY PERSON DIRECTLY INTERESTED MAY PETITION FOR REDETERMINATION. TO BE TIMELY, A PETITION MUST BE DIRECTED TO THE STATE BOARD OF EQUALIZATION WITHIN 30 DAYS IMMEDIATELY FOLLOWING THE DATE SHOWN AT THE TOP OF THIS NOTICE.

A PETITION NEED NOT BE IN ANY SPECIAL FORM BUT MUST BE IN WRITING AND MUST STATE THE SPECIFIC GROUNDS UPON WHICH IT IS FOUNDED.

IF A HEARING IS DESIRED, IT SHOULD BE REQUESTED IN THE PETITION. THE REQUEST SHOULD SPECIFY WHETHER AN INFORMAL MEETING WITH A HEARING OFFICER AT THE NEAREST DISTRICT OFFICE OR A HEARING BEFORE THE BOARD IN SACRAMENTO IS DESIRED. A 10 DAY NOTICE OF THE TIME AND PLACE OF HEARING WILL BE GIVEN.

PROMPT PAYMENT OF UNDISPUTED PORTIONS OF THE LIABILITY SHOULD BE MADE, THIS WILL PREVENT ACCRUAL OF ADDITIONAL INTEREST THEREON AND WILL NOT IN ANY WAY AFFECT THE PROTESTED PORTIONS.

ACCOUNTING DEPT.
RECEIVED MAR - 5 1971

PLEASE RETURN THIS COPY WITH YOUR PAYMENT

Exhibit A

BT-1.50 REV. 2(3-69)

STATE BOARD OF EQUALIZATION
DEPARTMENT OF BUSINESS TAXES
P. O. BOX 1799 SACRAMENTO, CALIFORNIA 95808

PM

EFFECTIVE DATE OF PAYMENT
MO. DAY YEAR

IN REPLY REFER TO:

M.C.R.S. Inc.
P.O. Box 511
San Pedro, CA 90733

DATE: December 28, 1973

ACCOUNT NUMBER
SH AL 01-909116

NOTICE OF REDETERMINATION

You are hereby notified that the action indicated below was taken on your petition for redetermination of Sales and Use Tax.

	AMOUNT			ch
	TAX	INTEREST	PENALTY	TOTAL
As Determined 1-1-63 to 12-31-70	21,046.95	4,187.27	2,104.69	27,338.91
Adjustment		3,577.82		3,577.82
As Redetermined	21,046.95	7,765.09	2,104.69	30,916.73

Monthly interest of 105.23 will accrue if not paid before 2-1-74
Additional penalty of 2,104.70 if not paid by 1-27-74

The Board concluded that the movement of passengers and property by vessel from the California mainland to Santa Catalina Island and vice versa is not interstate or foreign commerce within the meaning of the term as used in Sections 6368 and 6368.1 of the Revenue and Taxation Code.

cc: James H. Lyons
611 West 6th Street
Suite 3450
Los Angeles, CA 90017

DUPLICATE - FOR YOUR FILES

Exhibit B